[2019] UKFTT 0717 (TC)

TC07488

CAPITAL GAINS TAX – Contracts for land and properties to be built in Barbados – Properties not built – Disposal of contractual rights – Whether payments made under contracts prior to disposal of rights gave rise to losses for CGT purposes – Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/07732
TC/2017/07733

BETWEEN

(1) LADY LLOYD-WEBBER
(2) LORD LLOYD-WEBBER **Appellants**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE JOHN BROOKS

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1 on 22 and 23 October 2019

Sam Grodzinski QC and David Yates QC, instructed by Deloitte LLP, for the Appellants

Richard Vallat QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. Lord and Lady Lloyd-Webber appeal against closure notices issued, under s 28A of the Taxes Management Act 1970, by HM Revenue and Customs ("HMRC") on 15 September 2017 and 5 October 2017 respectively. The first closure notice disallowed their claims for losses for capital gains tax ("CGT") purposes made in their 2011-12 self-assessment tax returns. The second closure notice denied claims, made in their 2012-13 self-assessment tax returns, to carry forward the 2011-12 losses.

2. Lord and Lady Lloyd-Webber were represented by Mr Sam Grodzinski QC and Mr David Yates QC. Mr Richard Vallat QC appeared for HMRC. While I am grateful to them and have carefully considered all of their submissions, both written and oral, in reaching my conclusions, it has not been necessary, in this decision, to refer to every argument advanced at the hearing.

FACTS

3. The facts were mostly agreed and the following 'Statement of Agreed Facts' was produced by the parties:

> ***The Appellants***
>
> (1) The Appellants, Lord and Lady Lloyd-Webber ("**ALW**" and "**MLW**" respectively), are, and were at all material times, UK tax resident and domiciled in England.
>
> ***The Transactions***
>
> (2) In 2007 ALW & MLW decided to purchase two Villas in a proposed development in Barbados, known as Clearwater Bay. The development was to consist of approximately 50 villas and was to include a new Four Seasons Hotel, which would service the Villas.
>
> (3) On 14 August 2007 ALW and MLW entered into contracts (the "**2007 Contracts**") with Paradise Beach Limited and Paradise 88 Ltd (together the "**Vendors**") to purchase two plots of land, Lot 7 and Lot 15, together with Villas which, at the time the contracts were made, were still to be constructed on the plots. Cinnamon 88 Ltd was the proposed developer.
>
> (4) The effect of the 2007 Contracts was, accordingly, to provide that the Vendors were to build the Villas so that, on completion of the 2007 Contracts, ALW and MLW would acquire plots of land with complete Villas on them.
>
> (5) The purchase price for the Villa and land at Lot 7 was US$15,900,000, and for the Villa and land at Lot 15 was US$10,000,000.
>
> (6) The scheduled completion date under the 2007 Contracts was on or before 30 June 2009.
>
> (7) The 2007 Contracts specify amounts to be paid to the Vendors as a "Deposit", being US$3,180,000 for Lot 7 and US$2,000,000 for Lot 15. These amounts were paid by ALW and MLW to the Vendors in July 2007.
>
> (8) A further amount of US$100,000 was paid in respect of Lot 15 in July 2007 following the receipt of a payment instruction from Paradise 88 Ltd.
>
> (9) The 2007 Contracts provided for the following further payments of the purchase price to be made.

Lot 7

(a) US$1,590,000 to be paid when the Villa is certified 20% complete by the Quantity Surveyor.

(b) US$3,180,000 to be paid when the Villa is certified 40% complete by the Quantity Surveyor.

(c) US$6,360,000 to be paid when the Villa is certified 80% complete by the Quantity Surveyor.

(d) US$1,590,000 to be paid when the Quantity Surveyor issues a certificate of Practical Completion.

Lot 15

(a) US$1,000,000 to be paid when the Villa is certified 20% complete by the Quantity Surveyor.

(b) US$2,000,000 to be paid when the Villa is certified 40% complete by the Quantity Surveyor.

(c) US$4,000,000 to be paid when the Villa is certified 80% complete by the Quantity Surveyor.

(d) US$1,000,000 to be paid when the Quantity Surveyor issues a certificate of Practical Completion.

(10) The 2007 Contracts provided that if the Vendors failed to deliver the completed properties within a given time frame then the purchase price would be reduced by the sum of $200 per day for each day of delay. The 2007 Contracts do not, however, provide for what should happen if completion does not take place at all.

(11) By early 2008, delays to the expected timeline for completion of the Villas were identified.

(12) Austin Hickey (the "**Quantity Surveyor**") reported concerns about the slow progress in the developments, including over whether all of the necessary land for the development was in the possession of the Vendors, on 30 May 2008. Concerns over slow progress were again expressed by Mr Hickey on 2 July 2008. On 25 September 2008, Mr Hickey also wrote to ALW and MLW's private office with further details of the development progress.

(13) On 18 September 2008, ALW and MLW arranged for US$1,590,000 to be paid to the Vendors in compliance with the 2007 Contracts as stage payment for 20% completion of the Villa at Lot 7.

(14) Completion Stage Certificates were issued on 26 November 2008 reflecting 40% completion of the villa at Lot 7 and 20% completion of the villa at Lot 15.

(15) Consequently, instructions were issued on 27 November 2008 for a further payment of US$3,180,000 for 40% completion of the Villa at Lot 7 and $1,050,000 for 20% completion of the Villa at Lot 15.

(16) The total amount paid by ALW and MLW under the 2007 Contracts and in respect of the Villas at Lots 7 and 15 was $11,293,117.

(17) On 20 February 2009, Cinnamon 88 Ltd issued a press release noting that they had suspended construction works due to the need to conduct a review, precipitated by the global financial crisis.

(18) On 28 February 2009, Cinnamon 88 Ltd wrote to the Purchasers of all the villas noting the cessation of construction due to cash flow difficulties and providing updates as to certain matters with respect to the development.

(19) Various attempts were made by the developers to try and secure financing and recommence work, but ultimately these proved insufficient to get the project back on track. The partially built properties have never been completed and development has never been resumed. The partially built villas have been left to degrade and are currently derelict.

(20) On 18 January 2011, Paradise 88 Ltd wrote to ALW and MLW proposing certain amendments to the 2007 Contract in respect of Lot 7. These were not accepted.

(21) On 27 January 2011, Macfarlanes provided ALW and MLW with a list of issues that they may wish to consider with respect to any renegotiation of the agreement for the purchase of Lot 7.

(22) By mid-2011 ALW and MLW wished to bring their involvement with the 2007 Contracts to an end.

(23) On 9 September 2011, ALW and MLW entered in contracts with the Vendors (the "**2011 Contracts"**), whereby the 2007 Contracts were terminated. In return for giving up any rights under the 2007 Contracts, ALW and MLW received rights under the 2011 Contracts.

(24) The 2011 Contracts provide rights for ALW and MLW to recover some monies, subject to the development proceeding successfully and a sale of the Villas at Lot 7 and Lot 15 being completed. Development has never resumed, so ALW and MLW have never recovered any money under these provisions.

(25) The rights of ALW and MLW under the 2011 contracts had negligible value at the time of acquisition.

(26) On 15 March 2013 some minor amendments were made to the 2011 Contracts.

(27) The contracts are under Barbados Law, and the land which is the subject of the Contracts is real property in Barbados.

Course of dispute

(28) The 2011-12 tax returns of ALW and MLW, based on their own calculation, claimed capital losses equal to the sums paid under the 2007 Contracts, less the nil value of the new rights received in consideration under the 2011 Contracts. The losses claimed were £3,124,312 for ALW and £3,124,311 for MLW.

(29) HMRC raised questions in relation to the position in July 2013, but no formal enquiry notices were raised at that time.

(30) Notices of enquiries under s 9A Taxes Management Act 1970 were issued on 17 December 2013 in respect of the 2011-12 returns of both ALW and MLW.

(31) Notices of enquiries under s 9A Taxes Management Act 1970 were issued on 4 December 2015 in respect of the 2013-14 tax returns of ALW and MLW.

(32) Some of the capital losses claimed in 2011-12 were carried forward and offset against gains in future periods, including 2013-14.

(33) Following extensive correspondence and discussions between HMRC and Deloitte as agents for ALW and MLW, HMRC issued closure notices.

(34) On 15 September 2017, closure notices for 2011-12 were issued by HMRC to ALW and MLW, amending the returns to disallow the losses claimed.

(35) On 5 October 2017, closure notices were issued to ALW and MLW for 2013-14, amending the returns on the basis that the losses brought forward from 2011-12 could not be offset against gains in 2013-14 in line with the disallowance of these losses in the 2011-12 closure notices.

(36) As the matter had already been considered by all the relevant HMRC specialists who would look at any HMRC internal review, it was agreed that no internal HMRC review of the decision would be asked for. The parties further considered whether Alternative Dispute Resolution should be pursued. This was considered by both sides not to be appropriate due to the binary nature of the dispute.

(37) On 11 October 2017, ALW and MLW appealed the 2011-12 closure notices.

(38) On 18 October 2017, ALW and MLW appealed the 2013-14 closure notices.

(39) On 20 October 2017, ALW and MLW notified their appeals to the First-tier Tribunal.

4. In addition to the statement of agreed facts I heard from MLW.

5. She gave evidence, which I accept in full, that she and ALW, had holidayed in Barbados for many years with family and friends and, having previously rented, wanted to purchase a villa on the island as a holiday home but had been unable to find anything suitable. However, in 2007 they received a telephone call from one of their friends to let them know that he and others were planning to buy villas in the Clearwater Bay development on the west coast of Barbados. As a result MLW visited the London sales office for the development where she was given a presentation and provided with offer documentation. She subsequently flew to Barbados and whilst there selected Villa 7, a beach front villa, and Villa 15, situated directly behind Villa 7 which was intended to be used by the nannies and children to "enable the entire family" to be accommodated and holiday together.

6. MLW confirmed that at the time she and ALW entered into the 2007 Contracts she had not "turned her mind to the nature of the rights" they were purchasing. However, she did "not agree" that they had no interest in the bundle of contractual rights as an asset and had no intention to deal with these rights. Indeed her evidence was that although they wanted the villa they could have decided to sell these rights at a profit before the villa had been completed had they run out of money or found another villa that they preferred.

7. In her witness statement MLW said:

> "… had someone suggested to us that the millions of pounds we were spending were not acquiring or enhancing any valuable rights under the contracts (or we had no interest in achieving this) when they were signed and when the payments were made and that we were acquiring or obtaining nothing of any value at all, and weren't interested in doing so, I would have regarded that as being absolutely absurd."

8. Although ALW had also filed and served a witness statement he was not able to attend the hearing because of "unavoidable work commitments over which he had very limited control". In the circumstances HMRC sought to exclude his evidence. However, as the Tribunal may, under rule 15(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 "admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom", ALW's witness statement was admitted as hearsay evidence (ie a statement made otherwise than by a person while giving oral evidence in

proceedings, which is tendered as evidence of the matters stated). However, I attach very little, if any, weight to ALW's evidence which may not have been the case if he had given oral evidence which could have been tested under cross-examination.

LEGISLATION

9. The relevant provisions of the Taxation of Chargeable Gains Act 1992 ("TCGA") in force at the material time provided:

> **1 The charge to tax**
>
> (1) Tax shall be charged in accordance with this Act in respect of capital gains, that is to say chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets.
>
> …
>
> **2 Persons and gains chargeable to capital gains tax, and allowable losses**
>
> (1) …
>
> (2) Capital gains tax shall be charged on the total amount of chargeable gains accruing to the person chargeable in the year of assessment, after deducting—
>
> (a) any allowable losses accruing to that person in that year of assessment, and
>
> (b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment, any allowable losses accruing to that person in any previous year of assessment (not earlier than the year 1965–66).
>
> …
>
> **16 Computation of losses**
>
> (1) … except as otherwise expressly provided, the amount of a loss accruing on a disposal of an asset shall be computed in the same way as the amount of a gain accruing on a disposal is computed.
>
> (2) Except as otherwise expressly provided, all the provisions of this Act which distinguish gains which are chargeable gains from those which are not, or which make part of a gain a chargeable gain, and part not, shall apply also to distinguish losses which are allowable losses from those which are not, and to make part of a loss an allowable loss, and part not; and references in this Act to an allowable loss shall be construed accordingly.
>
> …
>
> **21 Assets and disposals**
>
> (1) All forms of property shall be assets for the purposes of this Act, whether situated in the United Kingdom or not, including –
>
> (a) options, debts and incorporeal property generally, and
>
> (b) … and
>
> (c) any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired.
>
> (2) For the purposes of this Act--
>
> (a) references to a disposal of an asset include, except where the context otherwise requires, references to a part disposal of an asset, and

(b) there is a part disposal of an asset where an interest in right in or over the asset is created by the disposal, as well as where it subsists before the disposal, and generally, there is a part disposal of an asset where, on a person making a disposal, any description of property derived from the asset remains undisposed of.

…

28 Time of disposal and acquisition where asset disposed of under contract

(1) Subject to section 22(2), and subsection (2) below, where an asset is disposed of and acquired under a contract the time at which the disposal and acquisition is made is the time the contract is made (and not, if different, the time at which the asset is conveyed or transferred).

(2) If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied.

…

38 Acquisition and disposal costs etc

(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to—

(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the asset,

(b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset,

(c) …

(2) For the purposes of this section and for the purposes of all other provisions of this Act, the incidental costs to the person making the disposal of the acquisition of the asset or of its disposal shall consist of expenditure wholly and exclusively incurred by him for the purposes of the acquisition or, as the case may be, the disposal, being fees, commission or remuneration paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal adviser and costs of transfer or conveyance (including stamp duty [or stamp duty land tax]) together—

(a) in the case of the acquisition of an asset, with costs of advertising to find a seller, and

(b) in the case of a disposal, with costs of advertising to find a buyer and costs reasonably incurred in making any valuation or apportionment required for the purposes of the computation of the gain, including in particular expenses reasonably incurred in ascertaining market value where required by this Act.

(3) Except as provided by section 40, no payment of interest shall be allowable under this section.

(4) Any provision in this Act introducing the assumption that assets are sold and immediately reacquired shall not imply that any expenditure is incurred as incidental to the sale or reacquisition.

…

43 Assets derived from other assets.

If and so far as, in a case where assets have been merged or divided or have changed their nature or rights or interests in or over assets have been created or extinguished, the value of an asset is derived from any other asset in the same ownership, an appropriate proportion of the sums allowable as a deduction in the computation of a gain in respect of the other asset under paragraphs (a) and (b) of section 38(1) shall, both for the purpose of the computation of a gain accruing on the disposal of the first-mentioned asset and, if the other asset remains in existence, on a disposal of that other asset, be attributed to the first-mentioned asset.

…

52 Supplemental

(1) No deduction shall be allowable in a computation of the gain more than once from any sum or from more than one sum.

…

144 Options and forfeited deposits

(1) Without prejudice to section 21, the grant of an option, and in particular—

(a) the grant of an option in a case where the grantor binds himself to sell what he does not own, and because the option is abandoned, never has occasion to own, and

(b) the grant of an option in a case where the grantor binds himself to buy what, because the option is abandoned, he does not acquire,

is the disposal of an asset (namely of the option), but subject to the following provisions of this section as to treating the grant of an option as part of a larger transaction.

(2) If an option is exercised, the grant of the option and the transaction entered into by the grantor in fulfilment of his obligations under the option shall be treated as a single transaction and accordingly—

(a) if the option binds the grantor to sell, the consideration for the option is part of the consideration for the sale, and

(b) if the option binds the grantor to buy, the consideration for the option shall be deducted from the cost of acquisition incurred by the grantor in buying in pursuance of his obligations under the option.

(3) The exercise of an option by the person for the time being entitled to exercise it shall not constitute the disposal of an asset by that person, but, if an option is exercised then the acquisition of the option (whether directly from the grantor or not) and the transaction entered into by the person exercising the option in exercise of his rights under the option shall be treated as a single transaction and accordingly—

(a) if the option binds the grantor to sell, the cost of acquiring the option shall be part of the cost of acquiring what is sold, and

> (b) if the option binds the grantor to buy, the cost of the option shall be treated as a cost incidental to the disposal of what is bought by the grantor of the option.
>
> (4) The abandonment of—
>
> (a) a quoted option to subscribe for shares in a company, or
>
> (b) a traded option or financial option, or
>
> (c) an option to acquire assets exercisable by a person intending to use them, if acquired, for the purpose of a trade carried on by him,
>
> shall constitute the disposal of an asset (namely of the option); but the abandonment of any other option by the person for the time being entitled to exercise it shall not constitute the disposal of an asset by that person.
>
> …
>
> (7) This section shall apply in relation to a forfeited deposit of purchase money or other consideration money for a prospective purchase or other transaction which is abandoned as it applies in relation to the consideration for an option which binds the grantor to sell and which is not exercised.

10. Unless otherwise stated, all subsequent statutory references are to provisions of the TCGA. I should also mention that it was agreed by the parties that, insofar as it was necessary to do so, I should proceed on the basis that the relevant law, that of Barbados, is the same as that of England and Wales.

DISCUSSION AND CONCLUSION

11. HMRC had initially argued, relying on the decision of the Upper Tribunal in *Hardy v HMRC* [2016] UKUT 332 (TCC) ("*Hardy*"), that the rights under the 2007 Contracts were not assets for CGT purposes. However, it is now common ground, on the basis of the decision of the Court of Appeal in *Underwood v HMRC* [2009] STC 239 (which was not cited to the Upper Tribunal in *Hardy*), that the decision in *Hardy* is per incuriam and not binding on the Tribunal.

12. Accordingly, it is not disputed that ALW and MLW acquired assets, namely the rights under the 2007 Contracts, and that there was a disposal of those rights when they were released in accordance with the 2011 Contracts. It is also not disputed that ALW and MLW suffered a commercial loss in that they have spent considerable sums and it seems unlikely that the villas will in fact be built. The issue between the parties is whether the amounts paid under the 2007 Contracts were, as ALW and MLW contend, paid to acquire/enhance their contractual rights and allowable as a deduction under s 38 or, as HMRC argue, the payments were made to acquire/enhance the estates in land which were the ultimate subject matter of the 2007 Contracts.

13. As Lord Wilberforce observed in *Aberdeen Construction Group Ltd v Inland Revenue Commissioners* [1978] AC 885, at 892-892, the legislation imposing CGT:

> "… is necessarily complicated, and the detailed provisions as they affect this or any other case, must of course be looked at with care. But a guiding principle must underlie any interpretation of the Act, namely that its purpose is to tax capital gains and make allowances for capital losses, each of which ought to be arrived at upon normal business principles. No doubt anomalies may occur, but in straight forward situations, such as this, the courts should hesitate before accepting results which are paradoxical and contrary to business sense. To paraphrase a famous cliché, the capital gains tax is a tax upon gains: it is not a tax on arithmetical differences."

14. In *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 Lord Wilberforce said, at 326:

> "The Capital Gains Tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction Group Ltd v Inland Revenue Commissioners* [1978] AC 885, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences."

15. However, more recently, in *HMRC v Blackwell* [2017] 1159 Briggs LJ (as he then was) said, at [22]:

> "While I accept that the capital gains tax legislation, and words, phrases and concepts used in it, including those in s.38, are generally to be interpreted on a basis consistent with business common sense, it by no means follows that there will in any particular instance be a conflict between business common sense and a careful juristic analysis of particular provisions. Even if there is, the clear language of statutory provisions by which gains are to be computed, and deductions allowed, may nonetheless prevail, even where the outcome might appear to be one which a businessman might find surprising."

16. It is therefore necessary to consider the CGT legislation, and s 38 in particular, in the light of these observations.

17. Section 38 (which is set out above) provides that for a deduction to be available the expenditure must be incurred "wholly and exclusively" either for the acquisition of the asset (under s 38(1)(a) or "on" the asset "for the purpose of enhancing" its value (under s 38(1)(b)).

18. Mr Vallat, for HMRC, contends that each limb of s 38 requires a consideration of the subjective intention of the person acquiring or enhancing the value of asset in addition to the actual consequences of the expenditure. However, Mr Grodzinski, for ALW and MLW, says that s 38 imposes an objective test. He argues that there is no reason why Parliament would have included an objective test in s 38(1)(a) but a subjective test in s 38(1)(b). He says that, in any event, the first part of s 38(1)(b) "the amount of any expenditure wholly and exclusively incurred on", clearly imports an objective test with the second part, "for the purpose of enhancing" etc, being a matter that can and ought to be ascertained objectively. As once it has been concluded that expenditure is "on" an asset it will follow from the objective facts that such expenditure was for such purposes.

19. Section 38 was considered in *Drummond v HMRC* [2007] STC (SCD) 682 ("*Drummond*") which concerned the CGT treatment on the disposal of second hand insurance policies, with a value of £1.75m, for which Mr Drummond had paid £1.96m. Having concluded that none of £1.96m had been incurred wholly and exclusively for the acquisition of the policies, the Special Commissioner (Sir Stephen Oliver QC) said, at [74]:

> "If I were wrong on that, it could, arguably, follow that Mr Drummond had for CGT purposes made an acquisition of the five policies. This leaves the question whether the whole £1.96 million was consideration given wholly and exclusively for their (assumed) acquisition or whether £210,000 should be left out of account as being the cost of the shelter. In the circumstances summarised above it would, I think, be unreal to view the transaction as one in which Mr Drummond acquired assets known to have a value of £1.75 million for £1.96 million. There was no evidence that he wanted to acquire and hold the policies. The entire weight of the evidence was to the contrary. As Mr Drummond put it (see paragraph 50 above) his concern was with the amount he could offset for tax and the costs if unsuccessful. The only possible inference, viewing the transactions realistically, is that the £210,000

> was not incurred "exclusively" (let alone "wholly") for the acquisition of the five policies. It was in reality money spent for the services of Simon McKie, London & Oxford and KPMG. I am therefore against Mr Drummond on "the £210,000 wholly and exclusively issue"."

20. In the Court of Appeal in the same case (see *Drummond v HMRC* [2009] STC 2206) Rimer LJ, with whom Longmore and Arden LJJ agreed, having cited the above passage from the decision of the Special Commissioner, said:

> "30. On appeal Norris J took a different view from the Special Commissioner on the first point. He held that there was no doubt that Mr Drummond had made a real purchase of the five policies and that he had disposed of them. The task was to calculate the gain on the disposal. In that calculation Mr Drummond was entitled to deduct that which he had expended on the acquisition, confined to 'the consideration in money … given by him … wholly and exclusively for the acquisition of the asset.' The total of £1.962m could be broken down into its constituent elements and matched to benefits or services. Norris J's conclusion was that (in round figures) £210,000 of the £1.962m was plainly not paid 'wholly and exclusively' for the acquisition of the policies (see the summary of the facts in paragraph [4] above). (I add that Norris J pointed out that it was not argued that the £210,000 was 'incidental costs' within the meaning of section 38(1)). It followed, he held, that the £210,000 could not be deducted under section 38(1). As the Special Commissioner had said in his alternative finding, with which Norris J agreed, it was only the balance of the consideration that could be so deducted. Norris J therefore allowed Mr Drummond's appeal to this extent.
>
> 31. Mr Way sought to persuade us that Norris J should have allowed Mr Drummond's appeal to the extent of allowing the whole of the £1.962m as a deduction under section 38(1). In my view that was, with respect, a hopeless endeavour. The Special Commissioner was in error in finding that no part of the £1.962m was incurred in the acquisition of the policies and Norris J was right to correct his decision in that respect. But, in case he was wrong in that respect, the Special Commissioner had also made a reasoned finding that the £210,000 element of the £1.962m was *not* 'given … wholly and exclusively for' their acquisition and Norris J agreed with him. In my judgment that was a finding of fact that was properly open to the Special Commissioner. Mr Drummond's challenge to this part of Norris J's decision is, in substance, a challenge to that finding. I see no basis on which this court can, might or should take any different view on it. I would accordingly also express my respectful agreement with Norris J's decision on the section 38 issue.

21. Mr Vallat relies on this passage from the decision of the Court of Appeal in *Drummond* in support of his argument that the test in s 38 is subjective or at least has a subjective element. However, I agree with Mr Grodzinski that the Special Commissioner, at [74] of his decision, did not take Mr Drummond's subjective state of mind, which was that he was not interested in the policies but the amount he could offset for tax and costs, into account. Rather, taking a realistic view of the transaction, the Special Commissioner found that the £210,000 was not incurred for the acquisition of the policies which, in my judgment, supports the objective, and in my view correct, approach to s 38 advocated by Mr Grodzinski.

22. Further support for an objective approach to s 38 can be found in the decision of the Upper Tribunal (Nugee J and Judge Nowlan) in *Price and others v HMRC* [2015] STC 1975 ("*Price*"). Under the sub-heading "Purposive Construction of Section 38" the Upper Tribunal stated:

> "67. We start therefore with the construction of s 38 purposively construed. Mr Ewart [counsel for the appellant] said that this required identifying what the consideration was paid for. He said that the FTT had mistakenly thought that the words 'wholly and exclusively' required them to answer the question why the person acquiring the asset had paid the money, whereas the correct question was simply what the money had been paid for.
>
> 68. We agree that s 38 requires a focus on what the money paid under a transaction was paid for, not on the subjective reasons why the payer made the payment. This is what the language, with its reference to 'consideration in money … given … wholly and exclusively for', requires.
>
> 69. But we do not accept that the FTT made the error of thinking that s 38 was concerned with why Mr Myers paid £6m. If they had thought that had been the question, the answer would have been very straightforward: there is no doubt that Mr Myers paid the £6m because he hoped that it would generate a capital loss and enable him to avoid paying income tax on almost all his earnings from employment. But the FTT do not ask themselves why Mr Myers paid the £6m. They ask themselves the different, and to our minds correct, question: what did he pay it for?"

23. The Upper Tribunal in *Price* (at [87] – [88]) also considered *Drummond* noting, at [89], that:

> "… It [*Drummond*] demonstrates that for the purposes of s 38 it is not enough simply to look at the consideration expressed in the contractual documents, as there is no doubt that Mr Drummond was contractually obliged to pay the whole £1.96m as the price for the 5 policies. Rather, one has to look at what the money was in reality paid for. In a case where the value of the assets acquired was known to be only £1.75m, the difference between that and the contractual price must in reality have been paid for something else as it would be unreal to regard Mr Drummond as having paid £1.96m to acquire assets known to be worth £1.75m. An examination of the facts showed what that something else was, in that case the various services of the advisers."

24. Accordingly, for the purposes of s 38 it is necessary, taking an objective approach, to consider what the payments made by ALW and MLW under the 2007 Contracts were, in reality, for.

25. Mr Vallat says that these were payments for the acquisition of land (in due course) and not for the purpose of acquiring the contractual rights as distinct assets. In support, Mr Vallat relies on *Hardy* in which having determined the appeal on the first issue before it, incorrectly holding that Mr Hardy's contractual rights were not an asset, the Upper Tribunal nevertheless went on to consider the remaining issues. In relation to the third issue, whether Mr Hardy had incurred an allowable loss in relation to forfeited deposits on two properties, the Upper Tribunal observed:

> "51. For the purposes of considering this issue, it must be assumed that Mr Hardy's rights under the Contract constituted an asset which was disposed of when the Contract was rescinded. Counsel for HMRC submitted that, even so, the deposit was not an allowable loss since it was not "wholly and exclusively" incurred in acquiring the asset as required by section 38(1) TCGA92. Counsel for Mr Hardy submitted that it was so incurred.
>
> 52. It is common ground that expenditure with a dual purpose may be allowable, but only if the main purpose is allowable and the other purpose is

> purely incidental or ancillary: see *Cleveleys Investment Trust Co v Inland Revenue Commissioners* [1975] STC 457 at 467 (Lord Emslie).
>
> 53. Counsel for HMRC submitted that the deposit had not been paid wholly or even mainly by Mr Hardy for the acquisition of contractual rights under the Contract, but as a part-payment of the purchase price of the Property. The acquisition of the right to enforce performance of the Contract was incidental. We agree with this.
>
> 54. Accordingly, we conclude that the forfeited deposit was not in any event an allowable loss."

26. However, as is accepted, the Upper Tribunal's decision on the third issue, which was preceded by what is now agreed to be an incorrect decision on the first issue, is obiter and therefore not binding. Additionally, given the very limited reasoning by the Upper Tribunal, in particular the absence of any consideration of s 43, "assets derived from other assets", or s 144, "options and forfeited deposits", I find myself unable to derive any assistance from *Hardy* in the present case.

27. Turning to s 43 (as set out above), this envisages the merger or change in the nature of an asset without there being a separate disposal. Mr Vallat contends that s 43 does not apply in the present case and that it would not have done so even if the land had ultimately been acquired by ALW and MLW. He says that in this case there is no question of any asset merging, dividing or changing its nature. Rather that on completion the right to acquire is exercised and, on exercise of that right, the taxpayer becomes the owner of the relevant estate in land. He argues that because the land and relevant estate in the land exists separately and independently from the contractual rights, those contractual rights cannot be an original asset that by "changing its nature" becomes the land as a new asset.

28. But even if that were the case Mr Vallat contends that the land did not derive its value from the contract. He says that this is because the value of the land is the same throughout and it is the ownership of the land that changes on completion, not its value. The most that can be said is that as a result of the contractual rights a right or interest would have been created in or over the land with the result that the land would be the original asset and the contractual rights the new asset. In addition, he relies on the contractual rights not being "in the same ownership" as the land at the moment of creation and therefore the second requirement for the application of s 43 cannot be met as it is not enough that the owner of the contractual rights later comes to own the land.

29. However, I agree with Mr Grodzinski that, on the completion of a contract, s 43 does allow expenditure initially incurred on obtaining contractual rights to be treated as expenditure on land as, in such circumstances there has been either a "merger" or "change in nature" of those contractual rights and, as it is the payment for those contractual rights that entitle a person to have the land conveyed to him on completion (and therefore be in the same ownership) the value of the land, "an asset", is "derived from" another "asset in the same ownership", namely, the contractual rights.

30. By contrast, because the grant of an option is treated under s 144(1) as a separate disposal, s 144(2) is required, if the option is exercised, to treat the grant and the transaction entered into under the option as a "single transaction" in which, if the option binds the grantor to sell, provides for the consideration for the option to be part of the consideration for the sale and, if the option binds the grantor to buy, provides for the consideration to be deducted from the cost of the acquisition. However, because of the effect of s 43 an equivalent provision is not necessary in circumstances where, such as the present case, there has not been completion of a contract.

31. Additionally, if Parliament considered that a loss in circumstances such as in the present case should be excluded from relief provision could have been made, as it was by s 144(7) in the case of losses resulting from a forfeited deposit.

32. Therefore, taking an objective approach and having regard to all the circumstances, I have come to the conclusion that although they entered into the 2007 Contracts with the intention of ultimately acquiring completed villas, the payments made by ALW and MLW under the 2007 Contracts were for the acquisition of contractual rights, the only asset they actually acquired. Not only does this correspond with the "real world" approach of Lord Wilberforce in *Aberdeen Construction* and *Ramsay* (given it is accepted that ALW and MLW suffered a real loss) but it is also consistent with the wider scheme of the TCGA, in particular in relation s 43 and s 144.

33. Accordingly I allow their appeals.

COSTS

34. This appeal was categorised as "complex" and neither ALW nor MLW made any application for exclusion from the costs regime under rule 10(1)(c) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. Therefore, the full costs-shifting regime is applicable. As a result, the Tribunal has a general discretion as to costs which were sought by both the Appellants and HMRC in the event they succeeded.

35. As I have not heard any submissions in relation to costs, I direct that, given my conclusion and if advised to do so, ALW and/or MLW may file and serve written submissions in support of an application for costs on the Tribunal and HMRC (to which HMRC may respond within 28 days of receipt and ALW and/or MLW reply within 14 days thereafter) within 28 days of release of this decision together with a schedule of costs in accordance with rule 10(3) of the Procedure Rules.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

36. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN BROOKS
TRIBUNAL JUDGE

Release date: 06 December 2019